

**Department of Telecommunications and Energy**  
**First Set of Information Requests**

**THE BERKSHIRE GAS COMPANY**  
**D.T.E. 03-89**

**Witness:** Karen L. Zink

**Date Filed:** October 31, 2003

**Question:**

**DTE 1-1**

Explain how the Company's requested exemption from G.L. c. 164, § 15A is in the public interest. As part of your answer, discuss the effect, if any, of current market conditions on the ability of the Company to price the securities at par value. Discuss whether the issuance of debt securities below par value will offer the Company any enhanced flexibility in entering the market quickly to take advantage of prevailing interest rates. Describe any benefit the Company's ratepayers will receive in the form of lower interest rates and a lower cost of capital.

**Response:**

As a general matter, given the likely method by which the Company will issue long-term securities pursuant to the proposed financing plans, it is not likely that the Company will issue debt securities at less than par value or the face amount thereof. Debt securities, however, often are issued with a coupon rate set at a multiple of one-eighth of one percent or by .05 percent. A comparable United States treasury security, that may be used as a reference price, is typically priced in increments of .01 percent. Accordingly, there may be a slight discount at final pricing to reflect this difference in reference price. The ability to issue debt securities below par value provides increased flexibility in pricing debt issuances with prospective investors. This flexibility should enhance the ability of the Company to issue debt securities in a timely manner and thereby take advantage of favorable market conditions. This flexibility is expected to result in lower overall financing costs. Consistent with Department precedent, the Company would amortize any discount over the life of a new debt security on a straight-line basis.

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**Question:**

**DTE 1-2** Discuss an appropriate method that the Department may establish to amortize any discount in the event the Company's request to issue debt securities below par value is approved.

**Response:** Discounts have been historically amortized over the life of the issued debt on a straight-line basis. This method has been accepted by the Department in previous decisions. See Boston Edison Company, D.T.E. 00-62 (2000). Therefore, the Company submits that an appropriate method to amortize any discount in the event the Company's request to issue debt securities below par value is approved would be to amortize the discount over the life of the issued debt security.

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**Question:**

**DTE 1-3** Compare the typical transaction costs for the issuance of debt securities through a competitive bid process and through a negotiated transaction.

**Response:** As an initial matter, the Company believes that, consistent with prior Department decisions on other recent utility petitions for authority to issue debt securities, under current market conditions debt issues with a face value of less than \$100 million have limited investor appeal due to liquidity concerns. This lack of liquidity with a Berkshire debt issue of up to \$20 million would likely result in an additional premium being demanded by investors of 25 basis points or more. Thus, even assuming that a meaningful formal, competitive bid process would be practicable given the likely lack of investor interest, a substantial premium would likely be charged to the Company. In addition, a public offering would involve underwriting costs of at least \$150,000 plus more substantial costs for accounting, audit and legal services listing fees, marketing fees and prospectus fees. These additional costs would likely be \$50,000 or more than in a privately negotiated transaction.

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**Question:**

**DTE 1-4**

Refer to Schedule KLZ-5. Does the Company have a plan to eliminate the net plant deficiency showing at June 30, 2003? If yes, please describe the plan.

**Response:**

As an initial matter, the Company's response to Information Request DTE 1-5 demonstrates that the Company has adequate net plant to support the full amount of the proposed financing. In any event, in light of its ongoing planning efforts, Berkshire Gas expects that its net plant will be increased more substantially during the ordinary course of business. As of June 30, 2003, the Company had been operating for three months without its union workforce due a work-stoppage. The timing of capital expenditures during this period resulted in reduced capital spending and, therefore, a somewhat lower level of Utility Plant in Service at June 30, 2003.

The Company currently plans to resume normal and, perhaps, somewhat increased capital spending upon completion of the current work stoppage. Projects for system improvements and replacements that are currently delayed are expected to be completed when the normal workforce returns. This expected increase in capital spending levels will increase the Company's Net Utility Plant and eliminate any net plant deficiency that was reflected on June 30, 2003 in Schedule KLZ-5, as subsequently revised in the response to Information Request DTE 1-5.

On Schedule KLZ-5a, the Company provided the same net plant analysis as of March 31, 2003, a time period that reflected normal operations. This analysis demonstrated a pro-forma positive net plant (even before the revision reflected in the response to Information Request DTE 1-5). The Company expects that the net plant test will remain positive with a return to normal capital expenditure levels.

Thus, the Company believes its plan to resume normal capital spending will result in the maintenance of excess net plant assuming the full issuance of securities expected to be issued pursuant to the proposed financing plan. Alternatively, consistent with prior Department precedent, the Department might authorize the issuance of debt up to the limits of available net plant and permit the Company to petition the Department for authority to issue the full amount of debt securities requested in this proceeding upon the submission of a filing demonstrating the satisfaction

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of the net plant requirement. See Commonwealth Electric Company,  
D.T.E. 02-51.

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**Question:**

**DTE 1-5** Refer to Schedule KLZ-5. Explain the basis for deducting Goodwill from the calculation of Total Securities & Debt. Identify any Department precedent on this issue.

**Response:** Berkshire Gas deducted Goodwill from the calculation of Total Securities and Debt in order to be consistent with the presentation used in the Company's rate filing in docket D.T.E. 01-56. In the cost of service schedules presented to the Department in D.T.E. 01-56, the Company reduced equity by the amount of Goodwill in order to set cast off rates on a stand alone or pre-merger basis. The return on equity that was granted to Berkshire in that case was based upon an equity reduced by Goodwill. On Schedule KLZ-5, Securities and Debt were reduced by Goodwill in order to present equity on the same basis that was used in the recent rate order. In the Balance Sheet presentation found in the annual Department returns, Goodwill is included in Net Utility Plant. The presentation used on Schedule KLZ-5 reduced Paid in Capital consistent with the presentation in D.T.E. 01-56, however, it is important to note that offsetting the Goodwill reduction to Securities and Debt was a corresponding reduction to Utility Plant in Service for the same amount of Goodwill.

Attached is Schedule DTE-1-5 which restates the Utility Plant to include Goodwill in Utility Plant in Service and to present Securities and Debt without a reduction for Goodwill, consistent with the presentation used in the DTE Annual Returns. When this presentation is used, an adjustment to Paid in Capital is necessary. The total Paid in Capital account is not 100% attributable to Utility Assets. Paid in Capital was created with the "Day 1" merger accounting entries. Energy East was assumed to have purchased all of the Berkshire Gas assets including both Utility and Non Utility assets. Therefore a percentage of Paid in Capital should be apportioned to Non-Utility. Schedule DTE 1-5 calculates this apportionment and removes the Non-Utility portion of the Paid in Capital from the Net Plant test. The results confirm that the Company has adequate Net Plant available for the issuance of the long-term debt proposed in this proceeding.

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**Question:**

**DTE 1-6** Refer to Schedule KLZ-1. Explain what is included in account "Goodwill (Net)."

**Response:**

The account Goodwill (Net) represents the Goodwill created from the accounting for the merger of the Company with Energy East Corporation of \$62,858,000 net of accumulated reserve for amortization of \$2,198,000. Accumulated reserve for amortization of Goodwill was created by accounting entries that amortized Goodwill over forty years in accordance with generally accepted accounting procedures. Goodwill was amortized through 2001. Beginning 1/1/2002 Goodwill is no longer amortized in accordance with FASB 142.

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**Question:**

**DTE 1-7** Identify the entry that is made to record Goodwill on the Company's books of account.

**Response:** Berkshire Gas Company merged with Energy East Corporation on September 1, 2000. Energy East purchased all of the shares of Berkshire Energy Resources (the holding company for Berkshire Gas) for \$38 per share. The difference between the stock purchase price and the net equity of Berkshire Gas resulted in an accounting entry to Goodwill in the amount of \$61,723,000. Other merger related costs that were booked to Goodwill amounted to \$1,135,000 for a total Goodwill at June 30, 2003 of \$62,858,000. On Schedule KLZ-1, the Goodwill of \$62,858,000 is net of accumulated amortization of \$2,198,000.



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**Question:**

**DTE 1-8** Explain how the Company determined the maximum rates for both the fixed and variable rate issuances that it has proposed in this filing. Describe how these maximum rates are reasonable.

**Response:** The Company made an assessment of potential market conditions during the term of the proposed financing plan. The Company also considered comparable requests by other utilities. A similar request by Commonwealth Electric Company sought approval of a generally comparable financing plan subject to interest rate caps for fixed rate securities of 11% and 20% for variable rate securities. See Commonwealth Electric Company, D.T.E. 00-62 (2000). The proposed caps are reasonable given the Company's incentive to reduce all costs, including the cost of debt. In addition, the higher cap for variable rate securities may help to avoid the need to prepay such securities at non-optimal times based upon a regulatory requirement.

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**Question:**  
**DTE 1-9** Did the Company rely on any specific financial forecast in determining its proposed maximum interest rates? If yes, please provide a copy.

**Response:** Please refer to the Company's response to Information Request DTE 1-8.

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**Question:**

**DTE 1-10** Refer to Direct Testimony of Karen L. Zink, page 10, lines 18 to 22: "The securities would carry either a fixed interest rate not to exceed the rate established by the Department or an adjustable rate which will vary with a market index to be designated at the time of the issuance or in accordance with a market auction mechanism but not to exceed a maximum". Assess the financial convenience for the Company of either alternative.

**Response:** The financial convenience to the Company may ultimately be served by the issuance of fixed rate debt securities, variable rate securities or some combination of both. Indeed, the Company has maintained both types of debt securities. Schedule KLZ-3 reflects the Company's long-term debt outstanding at the time of the filing of the petition in this proceeding. The 3.46% Commercial Note was determined based upon a variable rate of interest. The other securities listed all reflect fixed interest rates. This combination resulted in lower costs for the Company. The Company will evaluate the merits of fixed or variable rate debt issuances and seek to determine the approach with the least cost and greatest potential benefits for customers while maintaining an appropriate mix of fixed to floating debt.

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**Question:**

**DTE 1-11** Explain how the Company's request for a maximum fixed interest rate of 12 % per annum and for a maximum variable interest of 18 % per annum is consistent with the interest information shown on Schedule KLZ-8.

**Response:**

The Company established the proposed maximum interest rates based on historical interest rate environments in order to afford the Company maximum flexibility. Yields were rising at the time of the Company's filing in this proceeding and, therefore, the Company determined that a 12% per annum cap for any fixed rate security to be issued pursuant to the financing plan was appropriate. As to the higher cap for variable rate securities, the Company wishes to avoid the situation where the Company would be forced to prepay an outstanding variable rate security at a time when such action would be costly, for example due to "make whole" requirements or the cost of refinancing.

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**Question:**

**DTE 1-12** For adjustable rate debt, explain how the Company would use a market index in determining the applicable rate. Indicate what index would be used.

**Response:** Typically, adjustable rate debt securities are priced based upon an established and published index plus some "spread". This index is usually the Prime Rate or the London InterBank Offered Rates ("LIBOR"). For example, the Company's Term Note that matured on September 30, 2003 was based upon KeyBank National Association's Prime Rate plus 0.5%. The choice of index is typically a negotiated issue. Some variable rates permit the borrower to periodically "fix" a specified rate for a defined term, i.e. three months or six months, based upon an established formula. Any index rate option will be determined by the Company pursuant to negotiations consistent with the best interests of the Company and its customers.

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**Question:**

**DTE 1-13**

What would the effect be on the Company's "treasury locks" if the Department were to establish maximum interest rates for the debt issuances lower than the maximum interest rates proposed by the Company?

**Response:**

The Company does not expect that there would be a practical impact upon the proposed financing plan if the proposed rate cap was reduced slightly. The Company notes that rate locks will not affect the coupon rate of any debt security issued by the Company. The "effective" rate of such security would be decreased or increased due to the amortization of the rate lock transaction gain or loss. See the testimony of Karen L. Zink, p. 18. As long as the Company could secure a treasury lock at a rate lower than the maximum interest rate proposed by the Company, there would be no effect if the Department were to reduce the maximum interest rate.

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**Question:**  
**DTE 1-14** Explain how the Company determined the length of its proposed financing plan (through January 31, 2007). Explain how this length of financing plan is reasonable.

**Response:** The Company proposed that any debt securities that are issued pursuant to the proposed financing plan would be completed by January 31, 2007. This date coincides with the mid-period review of the Company's rate plan approved in D.T.E. 01-56. At that time, the Department will determine whether Berkshire can continue its long term rate plan without modification, or whether such plan might be terminated, in accordance with Department directives. As this analysis is likely to involve an analysis of the Company's costs, the Company elected to propose that the limit of its financing plan coincide with such date.

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**Question:**

**DTE 1-15** Provide examples of significant benefits of the proposed financing plan to the Company and its customers other than the terms and interest rate.

**Response:** The primary benefits associated with the Company's proposed financing plan are flexibility and responsiveness. The financial markets have exhibited unprecedented volatility in recent years. The ability to respond promptly and proactively to advantageous changes in market conditions is important in terms of minimizing the cost of capital. For example, a prompt closing or the use of treasury locks would enable the Company to take full advantage of a downturn in interest rates and reduce "floating" rate exposure. Rate locks are also a means to "lock in" savings through a reduced interest rate prior to negotiating and issuing a long-term debt security.



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**Question:**

**DTE 1-16** Provide a copy of the Company's most recent Form 10-K.

**Response:**

Berkshire Gas has not filed a Form 10-K since its merger with Energy East Corporation in September 2000. Rather, SEC filings are made at the Energy East Corporation level. Berkshire Gas has included Schedule DTE 1-16, audited financial statements as of December 31, 2002 as a substitute.

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**Question:**

**DTE 1-17** Refer to Direct Testimony of Karen L. Zink, page 17, lines 3 - 5: "These lenders are expected to be identified through some form of competitive solution initiated by the Company. The Company expects to construct the form of such solicitation in order to reflect market conditions at that time". Explain the general criteria to be used by the Company in the construction of such a solicitation.

**Response:** The Company would expect to identify potential lenders based on its experience in the financial market as well as the experience of other Energy East companies. The solicitation, most likely in the form of an RFP ("request for proposal"), would seek proposals describing the principal amount of securities to be issued by the Company, the rate of interest and other significant terms. The Company might also retain the services of a placement agent or other financial advisor to either assist in pursuing any competitive solicitation or to aid the Company in evaluating the terms of a proposed transaction if there are not meaningful alternative bids available to the Company.

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**Question:**

**DTE 1-18**

Refer to Direct Testimony of Karen L. Zink, page 8, lines 4 - 5: "Of the approximately \$39,793,400 of financing needs, approximately \$19,576,000 is expected to be funded from cash from operations..."

- (A) Explain the basis for the \$39,793,400 in financing needs; and
- (B) Explain the basis of the \$19,576,000 in depreciation. What method of depreciation is used?

**Response:**

- (A) The Company inadvertently included an outdated version of Schedule KLZ-6 in the initial filing. Attached is a corrected version of this schedule. Schedule KLZ-6 lists the components of the financing needs of \$39,793,400. The components include projected capital expenditures over the next four years of \$25,088,000 which is based upon the current capital expenditure level adjusted for inflation and new projects; a payoff of a Commercial Note of \$4,705,400 due 09/03; a payoff of a Medium Term Note of \$6,000,000 due 04/04; and, reduction of Short-Term Debt of \$4,000,000.
- (B) The basis of the \$19,576,000 of depreciation is the estimated book depreciation over the next four years taking into account the effect of new plant additions. The method of depreciation used for books has been calculated consistent with the requirements of the Department's Order in D.T.E. 01-56.

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**Question:**

**DTE 1-19** Refer to Schedule KLZ-6, page 1 of 2. Provide the basis for each year of expenditures for the Total Projected Capital Expenditures.

**Response:**

Referring to Schedule KLZ-6, page 2 of 2, the schedule included details listing the category of the anticipated capital expenditures. The 2003 expenditures of \$5,186,000 represent the Berkshire Gas capital budget for 2003 as approved by the Company's board of directors. The capital budget process includes a detailed evaluation of capital requirements for the maintenance and improvement of the distribution system, required DPW projects, general plant needs as well as new business extensions. The process involves a comprehensive collaboration from engineering, production, marketing and executive personnel and requires approval at the Energy East level. The 2003 base capital budget was adjusted for forecasted inflation and certain anticipated new projects to determine the annual capital requirements for 2004-2006.